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C O N F I D E N T I A L SECTION 01 OF 02 KINGSTON 002797

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STATE FOR WHA/CAR (BENT), EB/IFD/OMA (JUNCKER)
TREASURY FOR LAMONICA

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TAGS: [ECON](#) [EFIN](#) [JM](#)

SUBJECT: BOND. JAMAICAN BOND. LESS ATTRACTIVE THESE DAYS.

Classified By: CDA TIGHE FOR REASONS 1.5 (b) AND (d).

1. (C) Summary. The International Monetary Fund (IMF) gave its assessment of the Jamaican economy as part of the conclusion of its yearly Article 4 consultations with the Government of Jamaica (GOJ). Ratna Sahay, the Assistant Director of the Western Hemisphere Department for the IMF, acknowledged that the GOJ was likely to miss its target of a balanced budget. While she praised Jamaican openness to investment, Sahay reminded the GOJ that high crime and ineffective disaster management hindered economic growth and should be addressed. Meanwhile, the GOJ announced an unlimited USD bond offer at 8.125 percent on the local capital market after the failure of two consecutive JMD-denominated bonds. The local capital market reacted with confusion, owing to the recent JMD slippage, but their lack of information about the failed JMD bonds, as well as a new link between the GOJ and the Bank of Jamaica (BOJ) in the form of Colin Bullock (former Governor of the BOJ, now Financial Secretary in the Ministry of Finance (MOF)) may explain this apparent idiosyncrasy. End summary.

Background

2. (U) The IMF held a press briefing on December 14 to discuss the findings of its Article 4 consultations with GOJ officials. Ratna Sahay, the Assistant Director of the Western Hemisphere Department for the IMF, acknowledged that the GOJ was likely to miss its target of a balanced budget. She urged officials to continue to pursue this goal in the last quarter of the Jamaican fiscal year, noting that the IMF would be monitoring the country's debt management strategy. Sahay pointed out that debt levels in the region as a whole, while improving relative to the recent past, remain high, and under pressure from infrastructure demand and high petroleum prices. This, in turn, was having an adverse effect on Jamaica's economic growth rate, which remains low despite strong domestic and foreign private investment rates. With little discretionary capital after debt servicing, public sector investment suffers, creating a vicious circle.

3. (U) Sahay did praise Jamaican openness to investment, citing a lack of constraints in terms of regulations and bureaucratic procedures. She further noted that the country has two strong preconditions for favorable growth: proximity to the United States for the tourism and mining sectors in particular, and strong democratic traditions that engender investor confidence. Two obstacles outside of the fiscal arena, however, remain: GOJ ability to respond to natural disasters, and the escalating crime rate. If Jamaica bolstered its disaster management capabilities, and brought violent crime under control, the effects of sound fiscal policy could reach their full potential.

A cautionary note(

4. (C) The GOJ's budget woes, however, may be even worse than they at first appear. On December 20, the GOJ announced an unlimited USD-denominated bond offer at 8.125 percent on the local capital market. The market here reacted with incredulity, remarking that the GOJ was foolish to offer a USD-denominated bond issue at a time of exchange-rate instability. While it is no secret that poor revenue performance this year has created the need to finance expenditures through loan receipts (to the tune of some JMD 11 billion (USD 172 million)), what the capital markets do not know is that on December 7 and December 14, the GOJ had little success when it floated two local dollar-denominated bonds. The first raised only JMD 800 million (USD 12.5 million), while the second raised JMD 600 million (USD 9.4 million). The GOJ, however, is not obligated by law to divulge the results of these bond issues. Furthermore, two other bonds were coming due in December. To avoid any panic in the market, and to encourage those bondholders to roll over, the GOJ said nothing. Instead, they merely announced the USD bond offer.

5. (C) Courtney Williams (strictly protect), Senior Fiscal Economist at the Ministry of Finance (MOF), told Post that

the MOF never intended to float a USD bond in December for two reasons. First, the now-retired Financial Secretary, Shirley Tyndale, had convinced the MOF that a balanced budget was possible. Later in the year, when it became clear that this was not a realistic goal, it was assumed that the shortfall in revenues could be recouped with local-dollar bond issuances. With new, confidential projections from the GOJ that the fiscal deficit may be as large as 2 to 3 percent of GDP) a major deviation from the target - and after the JMD bonds fell short, the MOF was faced with two unsavory options: raise interest rates, or take a gamble on the exchange rate by issuing a USD bond, for which market appetite appears limitless.

16. (SBU) Institutional investors had been stockpiling cash for most of the year, planning to buy end-of-year bond issuances on the conventional wisdom that the BOJ would be forced to raise interest rates in order to combat inflation, which was considerably higher than expected. When this was not the case, these investors were unwilling to bite on JMD bonds at current rates of interest, under pressure as they were from seasonal liquidity problems common during Christmastime.

(but with a silver lining?)

17. (C) While there is some cause for concern that the GOJ will fall so far short of the balanced budget, there are also positive indications. Williams noted that a contributing factor to the BOJ decision not to raise interest rates, which they have every right to do, was an improving realization on the part of the BOJ that there is a balance between fiscal and monetary policies that is best facilitated through close cooperation. Williams is of the opinion that this new, cooperative spirit is likely the result of the fact that Colin Bullock replaced Shirley Tyndale as the Financial Secretary at the MOF. Previously, Bullock had been on the

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Board of Governors of the BOJ, and is considered by many to be a straight-talking technocrat, unlikely to make overstated claims to satisfy political expediency.

Comment

18. (C) It comes as no surprise that the GOJ will fall short of its target of a balanced budget, but the projected size of the fiscal deficit (2 to 3 percent of GDP), is greater than even the most pessimistic predictions. It is still possible that revenue collections may improve in the last quarter of the Jamaican fiscal year, but they will never surmount that level. It is also possible that there will be a concerted effort to improve tax compliance, especially in light of the fact that Finance Minister Davies will be challenging for the leadership of the People's National Party over the coming months. The new Director of Tax Administration, Vinnette Keane, also has a reputation as a no-nonsense technocrat, like Bullock, and will be unlikely to toe any party political line in her drive to improve tax compliance.

19. (C) It is likely that Davies will lay the blame for the failure to balance the budget squarely in the lap of external shocks, most notably the weather and the high commodity prices that have marked the year. It is also predicted that liquidity will improve in January, as demands for funds fall off after the holidays, and that the GOJ will be able to return to successful issuance of JMD-denominated bonds to finance end-of-year revenue shortfalls. Nevertheless, there is likely to be some consternation in the capital markets if the fiscal deficit is as bad as predicted. The appointments of Colin Bullock and Vinnette Keane will hopefully bring enough credibility and stability to fiscal policy to act as a countervailing force. End comment.

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